

**EXTREME DANGER TO MEMBERS AND EMPLOYERS IF SENATE BILL 165 FAILS TO PASS WITH NECESSARY SEPARATION FROM SERVICE.**

The primary and underlying reason for the introduction of SB 165 by Arkansas Teacher Retirement System (“ATRS”) is to comply with Federal Pension laws and the IRS requirements under those pension laws. As background, Congress passed the Pension Protection Act (“PPA”) in 2006. The PPA, as it is known, has provisions in it that are intended to permit in service retirement payments after a member has reached “normal retirement age.” This means that the PPA specifies when a retirement plan can allow a member to both work and receive a retirement payment at the same time. Although the law was first passed in 2006 to apply specifically to public pension plans, the IRS has given some leeway to public pension plans by delaying the effective date of the “normal retirement age” regulations until January 1, 2011. It appears no more delays will occur.

The PPA gives the IRS the authority to remove the tax and plan qualification status for any public retirement plan, such as ATRS, if laws and regulations do not comply with the PPA. SB 165 is intended to bring ATRS into compliance with the PPA. Currently, an ATRS member can retire well prior to age 62 (the PPA safe harbor “normal retirement age”) by having more than 28 years of credited service in ATRS. A member entering ATRS at age 22 could retire at age 50. Under current law, that member can return to work for an ATRS covered employer after only a 30 day separation period. The PPA requires significant separation if a member who has not reached “normal retirement age” is to return to work at an ATRS covered employer. The length of time is not defined in the PPA or in the IRS regulations. However, all experts with whom ATRS has addressed this issue has concluded that 30 – 90 days is too short a time, and that one year is a safe amount of time for separation. ATRS has chosen what ATRS believes is a defensible period of six months.

Public retirement plans have been the focus of IRS scrutiny recently, and that scrutiny appears likely to continue due to the significant changes in pension law that now applies to public plans. If ATRS does not adopt an appropriate separation period to ensure that members who have not reached “normal retirement age” do not return to employment without the legally required separation period, then the IRS would be entitled to find ATRS is not a tax qualified plan. Such a finding would be **DEVASTATING TO MEMBERS AND EMPLOYERS.**

Consequences to members include the following:

- 1) Once a member is vested, the 14% employer contributions payable to ATRS would be income taxable to the member, which means the member would pay income taxes on the 14% contributions and the employer would have to withhold additional money from the member’s payroll check for the income taxes on the employer contributions.
- 2) The member contributions would be income taxable to the member also. Again, ATRS would be paid the entire contribution amount, and the member would have additional taxes withheld for the Federal and State income taxes on the contributions.
- 3) A member would be unable to roll over a distribution from T-DROP or a lump sum payment to an IRA or other retirement plan since it would be placing an unqualified amount into a qualified plan.
- 4) If a member accidentally made a roll over to an IRA from an unqualified plan, then the member would be subject to a 6% excise tax that is imposed each year until the over contribution to the tax qualified plan is corrected.

Consequences to employers include the following:

- 1) The employer would be subject to failure to withhold remedies by the IRS if the employer failed to withhold taxes from the employer and member contributions that were taxable from an unqualified plan payment.
- 2) The IRS could seek payment from the employer if the employer failed to withhold income taxes from the member and the member failed to pay the income taxes when due.
- 3) The employers would be dealing with very complex and difficult issues with their members. A great disruption of the employer's most basic functions would occur if the tax qualified status of the retirement plan is lost. The morale of the workplace would suffer.

Consequences to ATRS:

- 1) The IRS could argue that ATRS would lose the tax-exempt status of income from the trust fund. ATRS would argue that ATRS, as a governmental entity, would have a second tax-exempt right under a second IRS code provision. If ATRS lost that argument, the soundness of the ATRS trust fund would be in the greatest of jeopardy.

Some might argue that this is not a threat. However, all the advisors to ATRS have treated this issue with utmost concern and priority. This is the last opportunity that ATRS has before a standard regular legislative session to comply with the provisions of the PPA. All ATRS advisors have stated that the current ATRS provisions on separation of service do not comply with the PPA requirements and the regulations that will become effective on January 1, 2011. The ATRS staff is convinced that action must be taken to protect the members of ATRS, the employers of ATRS, and the System itself. ATRS remains focused on protecting members and providing quality retirement benefits. This issue is significant and ATRS staff is willing to provide any needed information, attend any meetings or forums on the subject, and otherwise to answer and resolve questions and inquiries.

This information is being distributed through our new server list. In addition, if a member would like to be included on a separate individualized e-mail, a portal on the ATRS website will allow a member to register to begin receiving Executive Director updates and information on this and other issues. The ATRS website is located at [www.artts.gov](http://www.artts.gov). The Executive Director addressed this issue recently to a few groups. However, to ensure that the latest and most correct information is available, the information in this update has been developed after careful review and consultation with subject matter experts.

Conclusion:

This is a very important issue. ATRS staff will work to provide information on the issue and to ensure that the ATRS plan remains in compliance with all laws necessary to remain as a tax qualified plan. Our goal is to prevent the devastating impacts that could occur if the tax qualification of ATRS were lost by failure to comply with the PPA.